

ORIGINAL

NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

MIKE GLEASON, Chairman

WILLIAM A. MUNDELL

JEFF HATCH-MILLER

KRISTIN K. MAYES

GARY PIERCE

MAY 02 2008

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E-01345A-08-0228

DOCKET NO. E-01345A-08-

NOTICE OF INTENT TO INCREASE
EQUITY INTEREST IN ARIZONA
PUBLIC SERVICE COMPANY UNDER
A.A.C. R14-2-803.

NOTICE OF
REORGANIZATION

Pinnacle West Capital Corporation ("PNW") hereby provides the Arizona Corporation Commission ("Commission") with notice of its intent to increase its equity interest in Arizona Public Service Company ("APS" or "Company") by up to \$400 million during calendar year 2008. Such additional equity investment would be made during the balance of 2008 in the event that PNW determines that: (1) such action is appropriate to strengthen or maintain APS's financial integrity; and (2) PNW is able to make such equity investment at that time. Such notice is required under the provisions of A.A.C. R14-2-803 ("Rule 803"), as modified by Decision No. 58063 (November 3, 1992).

I. INTRODUCTION

Rule 803 requires notice to the Commission of "reorganizations" by a public utility holding company, such as PNW. For purposes of Rule 803, a "reorganization" includes the "acquisition or divestiture of a financial interest in an affiliate or a [Class A] utility." A.A.C. R14-2-801(5). APS is a Class A utility, and thus both it and PNW are subject to the provisions of Rule 803.

In Decision No. 58063, the Commission interpreted the language of Rule 803 to include any increase or decrease of the holding company's existing "financial interest" in a utility, even if the increase/decrease did not change the status of the utility as a wholly-owned subsidiary of the public utility holding company. But, Decision No.

1 58063 also effectively exempted from Rule 803's notice requirement any increase or
2 decrease in a financial interest in a utility that was less than the so-called "exempt
3 amount." Such "exempt amount" is based on the size of the consolidated public utility
4 holding company entity and, in the case of PNW and APS, is \$150 million per calendar
5 year. In this notice, PNW seeks authorization to exceed that exempt amount and infuse
6 a total of up to \$400 million into APS at the appropriate time this year.

7 II. SUMMARY

8 As recognized in the Commission's last order approving a similar equity
9 infusion into APS, equity infusions such as that proposed herein are highly beneficial to
10 APS because they "strengthen APS' capital structure and increase its ability to obtain
11 more favorable financing in the future." See Decision No. 68295 (November 14, 2005).
12 Indeed, in that Decision, the Commission found **no** basis to reject PNW's proposal to
13 infuse additional equity into APS, noting instead that:

14 [t]he proposed equity infusion would not impair the financial status of APS,
15 but rather strengthen it; it would not prevent it from attracting capital at fair
16 and reasonable terms, but rather improve the likelihood for obtaining
17 capital on better terms; and it would not impair the ability of APS to
18 provide safe reasonable, and adequate service.

19 *Id.* at 3.

20 APS must finance its billion-dollar per year capital spending requirements in
21 order to build and maintain its growing infrastructure. The Commission recently
22 granted APS authority to issue higher levels of continuing short-term and long-term
23 debt in Decision No. 69947 (October 30, 2007), primarily to assist APS in meeting
24 these capital spending requirements. This Decision recognizes the importance of APS
25 maintaining adequate equity by conditioning APS's issuance of long-term debt on
26 APS's maintenance of a specified common equity level and debt coverage ratio. By
27 approving PNW's proposal, the Commission will allow APS to both strengthen its
28 capital structure and avoid certain additional debt issuances later this year. This is an

1 important benefit considering the current volatility in the debt capital markets, in which
2 interest rates have risen compared to what they were last year and in which access to
3 the market has been much more limited.

4 On the other hand, any delay in PNW's ability to infuse equity into APS could
5 have potentially negative impacts on APS. As long as APS is prevented from receiving
6 additional equity, APS must rely on the debt market to meet its capital needs, resulting
7 in higher interest costs and associated coverage requirements, and a heightened
8 potential for downgrade by rating agencies (who carefully review the Company's
9 capital structure to ensure proper credit metrics, as described herein). Increasing short-
10 term debt levels also increases liquidity pressure since APS has less capital headroom
11 available to meet its spending needs. While an exclusive reliance on the debt market is
12 an inadvisable financial strategy at any time, it is particularly unwise in today's volatile
13 credit market – one that may or may not be willing to invest in APS's debt.

14 Thus, although Rule 803 allows the Commission 120 days to act upon this
15 notice, PNW respectfully requests that the Commission expedite its consideration of
16 this matter and act as quickly as possible in order to allow PNW the flexibility to infuse
17 equity into APS at the earliest opportunity. Accepting this notice will allow PNW to
18 continue to do its part to strengthen APS's weakening financial condition.

19 **III. THE NEED TO INCREASE APS EQUITY**

20 The equity investment requested in this notice is necessary for APS to maintain
21 investment grade credit ratings and to improve its financial stability in the face of
22 significant capital spending needs and other cash requirements over the next several
23 years. In light of the Company's growth and the increase in the cost of materials and
24 commodities necessary for APS's construction program, the Company's capital
25 expenditure requirements are expected to total more than \$1 billion in 2008 alone. As a
26 result, and as demonstrated in the Company's recent Debt Financing Application,
27 Docket No. E-01345A-06-0779, APS expects that it will have a roughly \$400 million
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1 cash flow shortfall caused by the difference between the funds received from operations
2 and the Company's extensive capital needs. See Affidavit of Barbara M. Gomez,
3 Exhibit A to APS's Verified Application in Docket No. E-01345A-06-0779, at ¶ 19 and
4 Attachment B (attached to this notice as Exhibit A). Whether this shortfall is financed
5 through the debt market or through equity investment has important implications on the
6 Company's credit rating.

7 Rating agencies determine credit ratings based on a variety of quantitative and
8 qualitative factors. In performing its qualitative analysis, the rating agencies assess the
9 business risk of a company by reviewing measures such as operations, management,
10 economic environment, power supply and regulatory risk. The rating agencies then
11 review both historical and projected financial metrics in light of the company's business
12 risk. The agencies are looking to see that the ratios stay within predetermined target
13 ranges.

14 One of the key financial metrics that rating agencies focus on is the Funds from
15 Operations ("FFO") to Debt ratio, or the ratio of operational cash flow to debt.
16 "Operational cash flow" is essentially the Company's earnings plus certain non-cash
17 expenses, such as depreciation and deferred taxes. Under Standard & Poor's ("S&P")
18 methodology, APS should have an FFO to Debt ratio of 18% or greater to maintain its
19 current ratings. Increasing APS's common equity positively impacts the Company's
20 FFO to Debt ratio, because APS can use equity rather than debt to meet its capital
21 needs, thus increasing the Company's equity and lowering APS's total debt (the
22 FFO/debt denominator).

23 APS's credit ratings are now at or near the bottom of the investment grade range
24 (rated BBB- by S&P and Baa2 by Moody's), with an FFO to Debt ratio of 18.6% at
25 year-end 2007. In addition, Moody's has assigned a "negative" outlook to APS's credit
26 rating, meaning that it is likely that Moody's will downgrade APS in the intermediate
27 term unless current and anticipated circumstances improve. In a December 17, 2007
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1 published credit opinion on APS, Moody's stated that the negative outlook on APS
2 "reflects Moody's view that, based on APS's significant capital expenditure plans,
3 absent any relatively near term supportive regulatory intervention or cost or leverage
4 reductions, credit metrics and financial flexibility are likely to weaken over the near-to-
5 medium term." In the financial world, "leverage" refers to the amount of debt that a
6 company uses to finance its assets. There is thus a direct correlation between APS's
7 "leverage reduction" cited by Moody's and PNW's proposed equity infusion into APS.
8 If APS has the flexibility to fund a portion of these capital requirements with equity
9 rather than debt (as the equity infusion contemplated by this notice would permit),
10 APS's leverage will be reduced, thus improving its credit metrics and helping to
11 maintain its investment grade credit ratings.

12 **IV. IMPACT OF HIGHER EQUITY RATIO ON APS**

13 There is no question that increasing APS's equity ratio will benefit the
14 Company's current financial condition. As shown in Exhibit B, even with the recent
15 rate increase, the Company's year-end 2007 FFO to Debt ratio stood at 18.6%--
16 dangerously close to the 18% threshold for junk status. But, as that Exhibit also makes
17 clear, APS's FFO to Debt ratio will fall below that threshold to 17.5% by year end 2008
18 and 15.6% by the end of 2009 absent additional efforts by both PNW and this
19 Commission to shore up APS's financial strength. In this notice, PNW proposes that it
20 be allowed the flexibility to do its part and increase the common equity interest in APS
21 by up to \$400 million by year end 2008, in the event that PNW has the ability and
22 determines that it would be strategically advantageous to do so. With the addition of
23 equity capital and the decrease in debt as a percent of capital, APS's FFO to Debt ratio
24 would remain within the BBB investment grade throughout 2008, resting at 19.4% (but
25 falling again to junk levels in 2009). See Exhibit B. Thus, in order to maintain even its
26 current weak investment grade credit ratings and potentially prevent downgrade to junk
27 status, APS needs additional equity to relieve the immediate and longer-term pressure
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1 on its financial metrics.

2 The beneficial impact of maintaining at least minimum investment grade debt
3 ratings has been discussed on several occasions, most recently in the Company's last
4 rate case, but also in its last several financing proceedings.¹ The ramifications of a
5 downgrade to non-investment grade are long-lasting and severe. At a minimum, a
6 downgrade would increase APS's cost of borrowing by as much as \$70 million to \$145
7 million annually over what it would have been absent a downgrade—an amount that is
8 ultimately borne by APS customers in the form of higher rates. (Indeed, this increase in
9 debt costs alone is the equivalent of, at a minimum, a 2.7% to 5.5% rate increase to
10 customers for **each** year that the Company's debt remains non-investment grade). At
11 worst, APS could suffer a total collapse of liquidity (that is, the ability to come up with
12 cash as needed) and could be denied access to the capital markets at the very time it
13 needs to access those markets the most to fund its substantial capital expenditure
14 requirements. The negative consequences resulting from a downgrade to junk are
15 exacerbated in the current financial market, from which APS has recently been denied
16 access and in which APS's cost of borrowing has increased. There is thus no doubt that
17 maintaining APS's investment grade credit quality and its commensurate access to the
18 capital markets at reasonable costs is essential for our customers and the state.

19 In addition to higher credit quality, more equity investment will mean less debt
20 and less interest than would otherwise be required. For every \$100 million not
21 borrowed, APS will save \$70 million in interest over a ten-year period. Assuming a
22 coverage ratio of 3.0 times, this means that for every dollar of saved interest cost, APS
23 will need **three** less dollars of pre-tax earnings to maintain that coverage ratio.

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27 ¹ See Docket Nos. E-01345A-02-0707, E-01345A-02-0840, E-01345A-05-0520, and E-01345A-06-0779, which
28 resulted in Decision Nos. 65796 (April 4, 2003), 65434 (December 3, 2002), 68295 (November 14, 2005) and 69947
(October 30, 2007) respectively.

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The original and 13 copies of the foregoing were
filed this 2nd day of May, 2008 with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007.

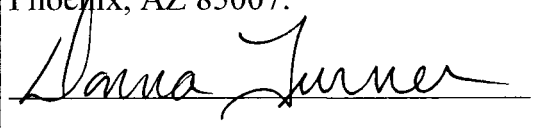


EXHIBIT A

Affidavit

and

Attachment B

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
BARRY WONG

IN THE MATTER OF THE APPLICATION
OF ARIZONA PUBLIC SERVICE
COMPANY FOR AN ORDER OR
ORDERS AUTHORIZING IT TO ISSUE,
INCUR, AND AMEND EVIDENCES OF
LONG-TERM INDEBTEDNESS AND
SHORT-TERM INDEBTEDNESS, TO
EXECUTE NEW SECURITY
INSTRUMENTS TO SECURE ANY SUCH
INDEBTEDNESS, TO REPAY AMOUNTS
PAID UNDER ANY PINNACLE WEST
CAPITAL CORPORATION GUARANTEE
OF ARIZONA PUBLIC SERVICE
COMPANY INDEBTEDNESS AND FOR
DECLARATORY ORDER

DOCKET NO. E-01345A-06-_____

**AFFIDAVIT OF
BARBARA M. GOMEZ**

IN THE MATTER OF THE APPLICATION
OF PINNACLE WEST CAPITAL
CORPORATION FOR AN ORDER OR
ORDERS AUTHORIZING IT TO
GUARANTEE THE INDEBTEDNESS OF
ARIZONA PUBLIC SERVICE COMPANY

STATE OF ARIZONA)
)ss.
County of Maricopa)

I, Barbara M. Gomez, upon my oath, do swear and attest as follows:

General

1. My name is Barbara M. Gomez. I am Vice President and Treasurer for both Arizona Public Service Company ("APS" or "Company") and Pinnacle West Capital Corporation ("Pinnacle West"). I am responsible for the Treasury functions at APS and Pinnacle West.

2. The assertions of fact contained within the Verified Application of the Company to which this Affidavit is attached are true and correct to my knowledge and belief.

1 3. The purpose of this Affidavit is to testify, from my personal experience and
2 involvement as the Treasurer, regarding the rationale behind the requests contained in the
3 Application.

4 **Specific Background Facts**

5 4. The Arizona Corporation Commission's ("Commission") Decision No. 55017,
6 dated May 6, 1986 (the "1986 Order"), allows the Company to have outstanding at any one time
7 long-term indebtedness (including current maturities) in an aggregate principal amount of
8 \$2,698,917,000. The 1986 Order permits the Company to issue, redeem or refinance and establish
9 and amend the terms of its long-term debt, as long as the total outstanding long-term debt does
10 not exceed \$2,698,917,000 during any period of more than thirty days. The fact that the long-
11 term debt limit can actually be exceeded for a period of thirty days or less enables APS to issue
12 new long-term debt in advance of an upcoming planned redemption.

13 5. In Commission Decision No. 65796 dated April 4, 2003 (the "2003 Financing
14 Order"), the Commission authorized the Company to issue \$500 million of long-term debt and to
15 loan the proceeds to Pinnacle West or Pinnacle West Energy Corporation ("PWEC"). The
16 purpose of the intercompany loan was to repay the Pinnacle West debt incurred to finance
17 construction of the Arizona electric generating plants built to serve APS native load and owned
18 by PWEC. In May of 2003, APS issued \$300 million of its 4.65% Notes due 2015 and \$200
19 million of its 5.625% Notes due 2033. The PWEC Arizona generation assets were later
20 transferred to the Company, and the intercompany loan was repaid. The \$500 million of long-
21 term debt that remains on APS' books today in effect financed the new generation assets. The
22 2003 Financing Order specified the \$500 million of debt that APS issued would not be counted
23 against the continuing debt limits authorized by the Commission in the 1986 Order.

24 6. By means of the 1986 Order and the 2003 Financing Order the Commission has
25 authorized APS to issue a total of \$3,198,917,000 of long-term debt. The Company is asking the
26 Commission to increase the continuing long-term debt limit in its Application.

27 7. Arizona Revised Statutes §40-302.D allows the Company to issue short-term debt
28 in an amount not to exceed 7% of its capitalization without Commission approval. However,

1 §40-302.D restricts the refunding or roll-over of any such notes. The Commission's Decision No.
2 54230 dated November 8, 1984 (the "1984 Order") allows the Company to refund or roll-over
3 any such short-term debt as long as the 7% limit is not exceeded.

4 **Benefits of Historical Financial Flexibility**

5 8. The 1986 Order and 2003 Financing Order have provided significant financing
6 flexibility that has served the Company's customers extremely well for, in the case of the 1986
7 Order, the past 20 years. The Company accessed the frequently volatile capital markets in a
8 timely and efficient manner, thereby reducing the Company's financing costs and the cost of
9 capital reflected in customer rates.

10 9. During the period from 1985 to the present, the Company has issued nearly
11 \$7 billion in long-term debt, taking advantage of troughs in the interest rate cycle and turning
12 over the Company's entire debt capitalization about three times. As a result, average long-term
13 debt costs have dropped from 10.5% in 1985 to 5.2% in 2005. See Attachment A for a graphical
14 representation of the decline in APS' long-term debt costs. In 1992 alone, the Company
15 voluntarily refinanced \$650 million of debt, producing total interest savings of some \$120 million
16 over the then remaining life of the refinanced debt.

17 10. The concept of an overall limit on the amount of long-term debt outstanding, as
18 contained in the 1986 Order, has provided APS financial flexibility to take advantage of optimal
19 financial conditions at the time of each financing. This flexibility occurs in a number of areas.
20 First, there is the ability to time the financing at the optimal point in terms of financial market
21 conditions, SEC disclosure requirements, and cash flow requirements. Markets are volatile, and
22 having the ability to quickly enter the markets to issue new debt yields better financing pricing
23 and terms. Second, there is the ability to size the borrowing at the optimal level. Since APS
24 knew it could enter the market as many times as necessary as long as it stayed within the limit, it
25 could do smaller debt issuances if that were advantageous at the time. Third, there is the ability
26 to obtain the best terms available at the time. Since the Company was given the ability to
27 negotiate the terms deemed appropriate, it could adapt to changing market conditions and get the
28 best terms available at the time of the financing.

1 11. APS' long-term debt portfolio compares quite favorably with its peers. The most
2 applicable index available for comparison purposes is the Lehman Brothers Electric Utility Index
3 ("Index"), which is comprised of over 250 bonds issued by about 100 companies. The weighted
4 average coupon of the Index at year-end 2005 was 6.10%, which exceeded APS' average coupon
5 on its taxable debt of 5.86% by 24 basis points. APS was able to achieve a lower cost of long-
6 term debt while having slightly longer dated bonds. APS has an average years to maturity on its
7 taxable debt of 12.0 years, which is 0.5 years longer than the 11.5 year average life of the Index.

8 12. The Company has also done an excellent job of managing its tax-exempt bond
9 portfolio. APS has outstanding approximately \$656 million of tax-exempt debt, the proceeds of
10 which financed pollution control equipment at its coal and nuclear power plants. In addition,
11 APS has refinanced the tax-exempt bonds several times in order to obtain lower interest rates or
12 more favorable credit enhancements. At December 31, 2005, the average cost of the tax-exempt
13 debt was 3.25%, and the average life was 24 years. The financing flexibility of the 1986 Order
14 has enabled APS to obtain this low cost form of financing, which results in a lower cost of capital
15 reflected in customer rates.

16 13. APS redeemed the last of its secured debt in April of 2004. Prior to that time APS
17 had issued debt that was secured by substantially all of the property of APS pursuant to the 1946
18 Mortgage and Deed of Trust. The 1946 Mortgage was almost 60 years old at the time of
19 termination, and it did not reflect current market standards for utility secured bond indentures. It
20 also contained certain restrictive covenants. By eliminating the 1946 Mortgage, APS has greater
21 financial flexibility. However, there may come a time when it is advantageous for APS to enter
22 into a new mortgage or other security agreements and once again issue secured debt.

23 14. APS manages its debt portfolio with the goal of having an appropriate mix of fixed
24 and floating rate instruments. The Board of Directors has established a Pinnacle West
25 consolidated limit on floating rate debt of 20% of capitalization. APS had 10.2% floating rate
26 debt at December 31, 2005. Most of the floating rate debt is in the tax-exempt instruments, which
27 have less volatility of interest rates than taxable debt. This is another example of how the 1986
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1 Order has enabled the Company to manage its debt portfolio so as to benefit the Company and its
2 customers.

3 15. A.R.S. Section 40-302.D and the 1984 Order enable the Company to issue short-
4 term debt up to 7% of capitalization. APS meets its seasonal working capital requirements with
5 short-term borrowings, often in the form of commercial paper. Since the statutory limit is a
6 percent of capitalization, as the Company has grown in size and its capital structure has increased,
7 the amount of short-term debt capacity has also increased. This has provided APS the flexibility
8 to continue to meet its growing working capital needs.

9 16. The Company has continuously complied with each of the terms and conditions of
10 the 1986 Order and the 2003 Financing Order and is in compliance with such Orders as of the
11 date of this Application.

12 17. The Company has operated under the 1986 Order and the 2003 Financing Order in
13 a manner that is compatible with sound financial policy and the public interest. By having ready
14 access to the capital markets as well as the ability to refinance existing debt when the opportunity
15 arises, the Company is able to reduce interest costs, which results in lower customer rates. The
16 new financing authority requested in the Application would enable APS to continue to manage its
17 debt requirements despite changing financial needs and conditions. Thus, the requested financing
18 order is compatible with sound financial policy and the public interest.

19 **APS' Long-Term Debt Financing Needs**

20 18. At September 30, 2006, the Company had total outstanding long-term debt
21 (authorized under the 1986 Order and the 2003 Financing Order) in an aggregate principal
22 amount of \$2,962,071,043. This amount includes current maturities of long-term debt. On
23 November 15, 2006, APS had a bond maturing in the amount of \$83,695,000. At December 31,
24 2006 the amount of long-term debt is expected to be approximately \$2.88 billion. As stated
25 above, the 1986 Order and 2003 Financing Order collectively limit long-term debt to an aggregate
26 principal amount of \$3,198,917,000. Comparing the expected year-end 2006 debt balance to the
27 limit on long-term debt shows that APS would have authorization to issue approximately an
28 additional \$300 million.

1 19. In light of the projected growth of the Company and its customer base, and the
2 resultant projected future financing needed to fund the Company's capital expenditure and
3 maintenance program and other cash requirements, the Company requests Commission
4 authorization to increase the long-term debt limitation by approximately \$1 billion so that the
5 Company may have up to an aggregate principal amount of long-term debt of \$4.2 billion. This
6 amount would include the \$500 million currently authorized in the 2003 Financing Order. The
7 additional \$1 billion is approximately three years of external financing requirements. See
8 Attachment B for details on the derivation of the additional \$1 billion of long-term debt authority
9 requested. Absent this higher continuing debt limit, APS' ability to access the debt capital
10 markets in a timely manner to take advantage of favorable market conditions will be severely
11 impacted. APS would be required to request Commission authorization for each debt issuance
12 once the current limit is met and would need to seek authorization well in advance of each
13 issuance to ensure the authorization was in place at the time the funding was required. In addition
14 to hampering the Company's ability to advantageously and strategically access the debt capital
15 markets, which could unnecessarily increase the Company's cost of capital, this would be
16 administratively inefficient for both the Commission and the Company.

17 20. APS requests to continue the ability to determine the terms of any long-term debt
18 issuances. Maturity, interest rate, discount and other factors would be negotiated in order to
19 obtain the most favorable terms possible for the Company and its customers.

20 **Other Components of Long-Term Debt Authorization**

21 21. The Company also seeks to confirm that the new continuing debt limit applies only
22 to debt for borrowed money. As a result of changes in accounting principles and interpretations,
23 there could be instances in which other types of financial obligations may be classified as debt in
24 the Company's financial statements in order to be in compliance with Generally Accepted
25 Accounting Principles. For example, there are currently issues regarding the accounting for long-
26 term power purchase agreements. Depending on the length and nature of the agreement, such
27 arrangements may be classified as capital leases and reflected as debt on the balance sheet of the
28 Company. Similar issues could apply to other contracts, such as long-term fuel supply contracts.

1 This could potentially erode the debt-issuing capability of APS and greatly affects the ability of
2 the Company to plan its normal financing activities if these arrangements are included in the
3 continuing debt limit or require prior authorization. By finding that such arrangements are not
4 subject to A.R.S. Sections 301, et seq., the new continuing debt limits will then only apply to
5 traditional borrowings, and the Company will not be at the mercy of changes in accounting
6 regulations.

7 22. In the future APS may find it necessary or advantageous to secure its debt with the
8 property of the Company. APS' credit ratings are currently just one notch above non-investment
9 grade. If APS' credit rating were to fall to non-investment grade, its access to the debt capital
10 markets would be severely curtailed. Even if APS were able to locate non-investment grade
11 investors, there would likely be much more restrictive covenant requirements. These restrictions
12 could include limitations on the use of proceeds, draconian financial tests, and restrictions on free
13 cash flow. In such an environment, APS may be required to issue secured debt in order to obtain
14 the necessary financing. In addition, there may be an interest rate or financial market
15 environment in which it is advantageous for APS to issue secured debt. While the 1986 Order
16 allowed APS to use its assets to secure debt, this authorization was granted under the 1946
17 Mortgage, which has since been retired. Therefore, APS is also requesting Commission
18 authorization to pledge or mortgage APS assets as security for its debt. This would include
19 authority to enter into a new mortgage and deed of trust that establishes a lien on all or
20 substantially all of the Company's property, as well as the authority to enter into separate security
21 instruments for one or more particular debt issuances.

22 23. It may be advantageous for Pinnacle West to guarantee APS debt issuances. APS'
23 debt is currently registered with the Securities and Exchange Commission ("SEC") under the
24 recently enacted short-form registration forms and procedures. In the event the Company is not
25 rated investment grade by at least one nationally recognized statistical rating organization at the
26 time of a debt issuance, a Pinnacle West guarantee would be necessary under the SEC rules to
27 allow continued utilization of these short-form registration forms and procedures. With a parental
28 guarantee, the Company would have greater access to the public financial markets. Pinnacle

1 West requests a waiver of or authority under A.A.C. R14-2-803 to guarantee the Company's debt
2 as needed from time to time. The Company also seeks authorization to reimburse Pinnacle West
3 for any amounts that Pinnacle West is required to pay under any such guarantee, along with
4 associated interest.

5 **APS' Short-Term Debt Financing Needs**

6 24. In addition to an increase in the long-term debt limit, the Company also requests
7 an increase in the short-term debt limit. A.R.S. § 40-302.D allows the Company to issue short-
8 term debt in an amount not to exceed 7% of its capitalization without Commission approval. The
9 1984 Order allows the Company to refinance and roll-over short-term debt as long as the 7% limit
10 is not exceeded. APS is required to obtain approval from the Commission to exceed the limit.
11 Based on its current capitalization, APS' short-term debt is limited to approximately \$420
12 million. As of September 30, 2006, APS had no short-term debt outstanding.

13 25. As APS continues to grow, so does its need for working capital. The 7% limit has
14 adequately met the seasonal working capital requirements of the utility for many years. However,
15 APS' load growth has resulted in an increased exposure to contracted commodity and purchased
16 power. These contracts have cash collateral provisions that can result in significant liquidity
17 demands on the Company as market prices change. APS has recently experienced changes in
18 cash collateral positions in the magnitude of \$100 million in just several days. If APS were to
19 become a non-investment grade company, the magnitude of the collateral changes would be even
20 more extreme since counterparties require additional collateral depending on credit quality. The
21 increased liquidity required to respond to volatile and increasing collateral requirements has
22 resulted in the need for short-term debt in excess of the currently authorized amount.

23 26. The Company recently completed an assessment of its liquidity needs and
24 determined that an additional \$500 million was necessary. In September of 2006, APS closed a
25 \$500 million revolving credit facility which was syndicated in the bank markets primarily with its
26 existing group of lenders. This facility is in addition to the \$400 million revolving credit facility
27 that is used for normal working capital requirements. In order to fully utilize the short-term debt
28 capability provided by the new revolver, additional Commission authority is required.

27. If the short-term debt limit is not increased, APS would have to issue long-term debt to fund its short-term needs. This is an uneconomic solution and does not follow the financial principle of financing short-term needs with short-term debt.

28. Based on the recent analysis of liquidity needs, including working capital and potential collateral calls, the Company has determined that an additional \$500 million of short-term debt authorization would be adequate. The Company is requesting the short-term debt limit be increased to the sum of 7% of capitalization and \$500 million, and that the Commission order continue to allow the refinancing and roll-over of such short-term debt.

29. APS requests to continue the ability to determine the terms of any short-debt issuances and to secure any such indebtedness if necessary or advantageous. Maturity, interest rate, discount and other factors would be negotiated in order to obtain the most favorable terms possible for the Company and its customers.

Summary

30. The financing flexibility provided in previous Commission orders has served the Company's customers extremely well by allowing the Company to access frequently volatile capital markets in a timely and efficient manner, thereby reducing the Company's financing costs and the cost of capital reflected in customer rates. APS faces a growing customer base requiring significant capital expenditures that will necessitate additional long-term debt financing. Additional short-term debt capacity is also required for growing liquidity needs. The Company is seeking a new financing order that authorizes the higher long- and short-term debt limits and other requested components. This new financing order would allow APS to continue to meet the growing financing needs in an efficient and cost effective manner that benefits APS' customers.

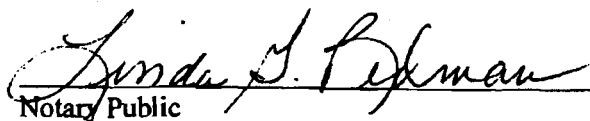
Dated this 15th day of December, 2006.

FURTHER AFFIANT SAYETH NOT.

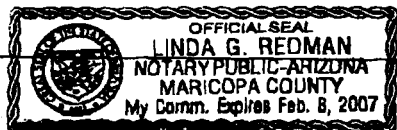
DT. Barbara M. Gomez
Barbara M. Gomez

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SUBSCRIBED AND SWORN TO BEFORE ME this 15th day of December, 2006, by
Barbara M. Gomez, Vice President and Treasurer of Arizona Public Service Company and
Pinnacle West Capital Corporation


Notary Public

MY COMMISSION EXPIRES:



Arizona Public Service
Financing Requirements 2007- 2009
(\$Millions)

Line #		2007	2008	2009 (same as 2008)	Total
1	Net Income	\$ 263	\$ 267	\$ 267	\$ 797
2	Depreciation and Amortization	376	395	395	1,166
3	Nuclear Fuel	41	43	43	127
4	Deferred Tax	(30)	(35)	(35)	(100)
5	Deferred Fuel	76	53	53	182
6	Interest on Deferred Fuel	(9)	(4)	(4)	(17)
7	AFUDC Debt/Capitalized Interest	(9)	(10)	(10)	(29)
8	AFUDC Equity	(13)	(15)	(15)	(43)
9	Funds from Operations	695	694	694	2,083
10	Common Dividends	(170)	(200)	(200)	(570)
11	Net Cash Flow	525	494	494	1,513
12	Construction Expenditures	895	924	924	2,743
13	Capitalized Property Taxes	6	6	6	18
14	Capital Expenditures	901	930	930	2,761
15	Additional Financing Requirements	\$ 376	\$ 436	\$ 436	\$ 1,248

Note: 2007 and 2008 projections included in rebuttal in amended 2005 general rate case. Imputed depreciation has been removed from the typical rating agency calculation of FFO to provide a more realistic estimate of financing needs.

EXHIBIT B

Arizona Public Service Projected Funds from Operations to Debt

* This graph is based on APS's most recent publicly available financial data.

